

ACCOUNTING PROCEDURE

TOPIC: Section 8--Capital Assets 3.0	EFFECTIVE DATE: 6/24/91
TITLE: Capital and Operating Leases	REVISION DATE: 9/24/04
AUTHORIZED BY: Cheryl Thompson, Financial Manager	PAGE 1 OF 12

BACKGROUND

The State of Wisconsin issues a Comprehensive Annual Financial Report (CAFR) based on generally accepted accounting principles (GAAP). GAAP, Statement of Financial Accounting Standards #13, requires that leases be classified in the financial statements as either capital or operating leases.

A lease is defined as an agreement between a lessor and a lessee that conveys to the lessee the right to use property or equipment for a specified period of time for stipulated cash payments (rents). Typically, the Department of Health and Family Services (DHFS) is the lessee, renting office equipment and real estate from lessors.

Note that the terms "lease" and "rental" are synonymous for the purpose of implementing this procedure. All lease and/or rental transactions should be reported to the Bureau of Fiscal Services (BFS) unless specifically excluded below.

It is recommended that funds be encumbered for all lease payments, including payments with a value less than \$5,000.00. A purchase requisition is required for all lease agreements over \$100.00.

EXCLUSIONS

The following transactions described below will not be classified as a lease transaction. No other lease reporting requirements apply.

1. Costs associated with the purchase of UPGRADES for software already owned.
2. Leases/Rentals with a total lease term of LESS THAN one year without extensions beyond a year.

Questions on whether a transaction should be excluded should be directed to the Bureau of Fiscal Services - Special Services and Financial Statement Section (SSFS).

PROCEDURES

A distinction is made in the reporting requirements between the Division of Disability and Elder Services (DDes) Institutions and the remaining organizations within the DHFS.

DDES Institutions

Each DDES Institution shall appoint a lease coordinator. Revisions to the coordinator's name and telephone number shall be forwarded to the BFS/SSFS, by the 5th working day after the close of the quarter.

Each DDES Institution's lease coordinator shall submit on a quarterly basis, by the 5th working day after the close of the quarter, the following information to BFS/SSFS:

- A Lease Transmittal Notice: [DMT-455](#) (see Attachment 1). Please note that the Lease Transmittal Notice should be submitted quarterly to BFS whether or not any new leases have been initiated.
- The lease documents and/or information pertaining to each lease, as outlined in the 'Type of Leases and Their Reporting Requirements' section. Documentation and information is required to be submitted when one of the following situations occurs:
 - A new lease is initiated during the quarter.
 - An existing lease is extended or renewed in the quarter.
 - An existing lease has not been previously reported.
 - A new purchase order is issued for an existing lease.

NON-DDES Institutions

The lease information for Non-DDES Institutions will be reported to BFS/SSFS via the BFS Purchasing Section. The Chief of the Purchasing Section will advise the BFS/SSFS of divisional purchasing manager assignments. Changes in staffing will be forwarded as they are made.

The BFS Purchasing Section will send the following information by the 5th working day after the close of a quarter.

- A Lease Transmittal Notice: [DMT-455](#) (see Attachment 1). Please note that the Lease Transmittal Notice should be submitted quarterly to the BFS/SSFS whether or not any new leases have been initiated.
- The lease documents and/or information pertaining to each lease, as outlined in the 'Type of Leases and Their Reporting Requirements' section. The BFS Purchase and Services Section is exempt from submitting lease forms DMT-456 and DMT-457.

Documentation and information is required to be submitted when one of the following situations occurs:

- A new lease is initiated during the quarter.
- An existing lease is extended or renewed in the quarter.
- An existing lease has not been previously reported.
- A new purchase order is issued for an existing lease.

TYPES OF LEASES AND THEIR REPORTING REQUIREMENTS

DDES and NON-DDES Organizations

All lease/rentals must be reported to BFS/SSFS unless specifically excluded, as discussed previously. Generally, a lease will fall into one of four categories outlined below.

- A. Equipment RENTALS negotiated through State Procurement Operational Bulletins.

- B. Real Estate (land and/or buildings) Leases negotiated through Department of Administration (DOA).
- C. All other leases not included in category "A" or "B" above, where the division is the lessee.
- D. All leases where the division is the lessor (a state or a non-state agency rents property or equipment from the division/institution). Report lease agreements with other organizations within the Department, other state agencies, or non-state agencies.

A description of each lease type and the reporting requirements for each lease type is outlined in the following paragraphs.

A. Equipment RENTALS negotiated through State Procurement Operational Bulletins.

This category includes but is not limited to photocopy and facsimile machines, pagers and other similar equipment. The majority of the department's leases will be included in this category.

The four characteristics of an operating lease agreement are detailed below, and can be confirmed from information in the Procurement Bulletin.

1. The lease does not transfer title/ownership to the state;
2. The lease does not contain a "bargain" purchase option;
3. The lease does not have a non-cancelable lease term greater than or equal to 75% of the estimated economic useful life of the leased asset;
4. The lease does not include minimum rental payments less executory costs (i.e. maintenance, insurance, taxes and supplies) with a present value greater than 90% of the fair market value of the leased asset.

Please note that this section applies only to RENTALS negotiated through State Procurement Operational Bulletins. LEASE PURCHASE transactions negotiated through State Procurement Operational Bulletins should be reported in accordance with section "C" below.

For leases in category A the following information should be sent to the BFS/SSFS: - A copy of the purchase order, or the purchase request if the transaction is processed as a direct pay, along with the Operating Lease Agreement: [DMT-456](#) (Attachment 2).

B. Real Estate (land and/or buildings) Leases negotiated through DOA.

This category ONLY includes leases negotiated by the Department of Administration (DOA) for State agencies where a private vendor, not affiliated with the State, leases real estate to a State agency.

There are no reporting requirements for leases in category B. To correctly apply this exemption, be sure to read the last paragraph in this category.

Real estate leases included in this category should be assumed to be operating leases, unless BFS/SSFS informs the organization otherwise. BFS/SSFS will inform organizations of any leases classified as capital

leases based on a DOA review of the leases involved and the proper costs to be included in the capital asset records. Those assets acquired in a capital lease transaction must be added to the organization's capital asset records.

This category DOES NOT include real estate leases where the organization negotiates a lease directly with the lessor. This type of lease should be reported in accordance with category "C" below.

C. All other Leases not included in category "A" or "B" above, where the organization is the lessee.

Leases in category C generally originate when an organization leases property or equipment directly from a vendor, or when an organization enters into a lease purchase agreement which originated through a State Procurement Operational Bulletin.

Leases included in this category should be assumed to be operating leases, unless BFS/SSFS informs the Organization otherwise. BFS/SSFS will inform organizations of any leases classified as capital leases based on their review of the leases and the proper costs to be included in their capital asset records. Those assets acquired in a capital lease transaction must be added to the capital asset records.

For leases in category C the following information should be sent to BFS/SSFS: - Signed lease documents, purchase orders, a copy of the purchase requisition if the transaction is processed as a direct pay, and other related lease information along with the Lease Agreement Summary: [DMT-457](#) (Attachment 3).

To properly classify **DHFS negotiated leases**, specific information, as listed below, must be outlined in the lease document or detailed in an appendix attached to the lease document. The appendix must be referenced in the lease document or signed as a separate document by the same individuals signing the lease document. (See Attachment 4 for a glossary of lease terms).

- Name of Lessor
- Transfer of Ownership: does title pass to State?
- State Purchasing Bulletin Number (if applicable)
- Asset Description
- Lease period
- Lease cancellation provisions
- Lease payments: amount (specify annual, quarterly or monthly basis)
- Payment date(s)
- Renewal terms: payments, time period and likelihood of exercising option
- Penalty for failure to renew or extend lease amount and terms
- Purchase option: amount, date option to be exercised, and likelihood of exercising option
- Executory Costs: type and value
- Fair market value of each item
- Economic life
- Lessor's implicit interest rate
- Residual Value: amount -- guaranteed or unguaranteed

- Contingent rental terms

D. All Leases where the Division/Institution is the LESSOR (a state or a non-state agency rents property and/or equipment FROM a DHFS Division/Institution). Report lease agreements with other organizations within the Department, other state agencies or non-state agencies.

Leases included in this category are assumed to be operating leases, unless BFS/SSFS informs the organization otherwise. BFS/SSFS will inform organizations of any leases classified as capital leases based on their review of the leases and the proper costs to be excluded from their capital inventory. Those assets leased out in a capital lease transaction must be removed from the organization's capital inventory.

For leases in Category D the following information should be sent to BFS/SSFS: - Signed lease documents, purchase orders, purchase request if the transaction is processed as a direct pay, and other related lease information along with the Lease Agreement Summary: [DMT-457](#) (Attachment 3).

To properly classify **DHFS negotiated leases**, specific information, as listed below, must be outlined in the lease document or in an appendix attached to the lease document. The appendix must be referenced in the lease document or signed as a separate document by the same individuals signing the lease document. (See Attachment 4 for a glossary of lease terms.)

- Name of lessee
- Transfer of ownership: does title pass to lessee?
- Asset description
- Lease period
- Lease cancellation provisions
- Lease payments: amount (specify annual, quarterly or monthly basis)
- Payment date(s)
- Renewal terms: payments, time period and likelihood of exercising option
- Penalty for failure to renew or extend lease - amount and terms
- Purchase option: amount, date option to be exercised, and likelihood of exercising option
- Executory Costs: type and value
- Fair market value (cost) of each item
- Economic life
- Residual Value: amount -- guaranteed or unguaranteed
- Contingent rental

ATTACHMENTS

1. Lease Transmittal Notice: DMT-455
2. Operating Lease Agreement: DMT-456
3. Lease Agreement Summary: DMT-457
4. Glossary of Lease Terms (3 pages)

REFERENCES

DOA GAAP Conversion Manual V.10 (Go to
http://www.doa.state.wi.us/pagesubtext_detail.asp?linksubcatid=458&linkcatid=140&linkid=1, then
click on State Wisconsin Accounting Manuals)

CONTACTS

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DEPARTMENT OF HEALTH AND FAMILY SERVICES

Division of Management and Technology

DMT-455 (Rev. 2/01)

STATE OF WISCONSIN

Fixed Assets 3.0

LEASE TRANSMITTAL NOTICE**Direct Questions About This Form To:**Bureau of Fiscal Services
Special Services & Financial Statements

Date – Notice

Reporting Period – Leases for
the Quarter Ending**TO:**Department of Health and Family Services
Division of Management and Technology
Bureau of Fiscal Services
Special Services & Financial Statements**FROM:**

Check the Appropriate response below.

- ☐ There are no new or previously unreported leases to submit this quarter.
- ☐ There are new or previously unreported leases to submit this quarter. The following information is included with this transmittal:

Enter the appropriate number for each lease category submitted.

Number Submitted

Equipment Rentals Negotiated through State Procurement Operational Bulletins.

Also Enclosed: A Copy of the Purchase Order and an Operating Lease Agreement (Form DMT-456) for each lease.

Real Estate Leases Negotiated through DOA.

Also Enclosed: Listing of These Leases.

Other Leases Where the Division is the Lessee.

Also Enclosed: Signed lease documents, purchase orders and other related lease information along with the Lease Agreement Summary (Form DMT-457) for each lease.

Other Leases Where the Division is the Lessor.

Also Enclosed: Signed Lease documents, purchase orders and other related lease information along with the Lease Agreement Summary (Form DMT-457) for each lease.

DEPARTMENT OF HEALTH AND FAMILY SERVICES

Division of Management and Technology
DMT-456 (Rev. 2/01)

STATE OF WISCONSIN

Fixed Assets, 3.0

OPERATING LEASE AGREEMENT

Direct Questions About This Form To:

Bureau of Fiscal Services
Special Services & Financial Statements

GENERAL INFORMATION

DHFS Division and / or Institution Name

Lessor Name

Description of Leased Asset

Purchase Order Number	State Procurement Operational Bulletin Number (effective at the lease inception date)	Lease Begin Date	Lease End Date (See Note 1)
Payments Due (Check One) <input type="checkbox"/> Monthly <input type="checkbox"/> Quarterly <input type="checkbox"/> Annual	Number of Payment Periods in Lease Term	Payment Due Date	Minimum Payment Amount (See Note 2)

MINIMUM RENTAL PAYMENTS

Provide information from the beginning to the end of the lease term.

	State Fiscal Year	(A) Minimum Payment Amount	(B) Number of Payments	(A) x (B) Total Minimum Annual Payments
1st Year				
2nd Year				
3rd Year				
4th Year				
5th Year				
6th Year				
7th Year				
8th Year				
9th Year				
10th Year				
After				
TOTALS				

NOTE 1 The lease term should contain periods for which renewal options apply if it is probable the renewal will be exercised. However, if the renewal period is cancelable with relatively short notice (i.e., 30 – 60 days) of your intent to terminate the lease, the renewed lease is considered a month-to-month lease and the renewal period should not be included in the lease term above.

NOTE 2 The minimum payment amount does not include any part of the payment that is contingent on an event (i.e., number of copies made). For instance, divisions are billed per copy for copier rentals. However, the State Procurement Operational Bulletin, for copier rentals, states a vendor can bill the lessee for the minimum number of copies within the volume band the copier was rented from regardless of the actual copies made. Thus, the minimum payment in this case would be the per copy charge times the minimum number of copies for the volume band even if no copies were made during the period.

DEPARTMENT OF HEALTH AND FAMILY SERVICES

Division of Management and Technology

DMT-457 (Rev. 02/01)

STATE OF WISCONSIN

Fixed Assets, 3.0

LEASE AGREEMENT
SUMMARY

Direct Questions About This Form To:

Bureau of Fiscal Services
Special Services & Financial Statements

Division Completing This Form is the:

☐ Lessee☐ Lessor

Date This Form Completed

DHFS Division

Lessee or Lessor Name (**Lessees:** Provide Lessor's Name. **Lessors:** Provide Lessee's Name.)

Description of Leased Item

Lessee's Only: Purchase Order Number

State Procurement Operational Bulletin Number (if applicable)

YES NO

☐ ☐ Is the leased item included on your capital inventory?☐ ☐ Does the lease transfer ownership of the leased item to the State by the end of the lease term?☐ ☐ Does the lease contain an option to purchase the leased item?☐ ☐ Do you intend to exercise this purchase option?

Purchase Option Amount: _____

Purchase Option Date(s): _____

Lease Begin Date

Lease End Date

Is the Lease Cancelable? ☐ No ☐ Yes – If "Yes", explain the cancellation provisions below.

YES NO

☐ ☐ Does the lease contain an option to renew the lease and extend the lease term?☐ ☐ Do you intend to exercise this option to renew this lease and extend the original lease term?

Optional Renewal Period: _____

Renewal Option Payment Amount: _____

Renewal Payment Due (check one)

☐ Monthly☐ Quarterly☐ Annually

Is there a penalty if the Renewal Option is not exercised?

☐ Yes ☐ No

Amount of Non-Renewal Penalty

Estimated Economic Useful
Life of Leased Item

Payment Due Date

Payments Due (check one)

☐ Monthly☐ Quarterly☐ AnnuallyNo. of Payment Periods
In Lease Term

Payment Amount

Are there future rental payments contingent on a future event?

☐ Yes ☐ No

Explain the Contingent rental terms below:

Executory Costs Paid by Lessor (Lessee Agreements)
or Division (Lessor Agreements)Payment
Amount

Payment Frequency

Monthly

Quarterly

Annual

Estimates of these amounts are acceptable.

Enter "Division Paid" if the division is responsible for these costs.

Insurance

Maintenance

Taxes

Other

Will the leased asset have a residual
value at the end of the lease?☐ Yes ☐ No

Residual Value

☐ Guaranteed ☐ Unguaranteed

Residual Value Amount

Lessor's Interest Rate Implicit
in the Lease (if known)Fair Market Value of Leased Item
(Amount required to purchase item
outright rather than lease it.)**Lessors Only:**Cost of Leased
Item to DivisionCollectability of
Payments Required
from Lessee is
Reasonably Predictable☐ Yes ☐ NoNo important uncertainties surround the amount of
unreimbursable costs yet to be incurred by the lessor
under the lease. (Lessor's performance is substantially
complete or future costs are reasonably predictable.)☐ Yes ☐ No

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Glossary of Lease Terms

Bargain purchase option. A bargain purchase option is a lessee's option to purchase the leased property at a bargain price that makes the exercise of the option almost certain.

Bargain renewal option. A bargain renewal option is a lessee's option to renew the lease at a bargain rental price that makes the exercise of the option almost certain.

Contingent rental. Contingent rentals are those which cannot be determined at the inception of the lease because they depend on future factors or events. Contingent rentals can either increase or decrease lease payments. Examples are rental payments based on future sales, future machine hours, future interest rates.

Estimated economic life. The estimated remaining period during which the property with normal repairs and maintenance is expected to be economically usable by one or more users for the purpose for which it was intended at the inception of the lease without limitation by the lease term.

Executory costs. Costs such as insurance, maintenance, and taxes. If paid by a lessor any lessor's profit on those costs is considered the same as executory costs.

Fair rental. Fair rental is the rental rate for similar property under similar lease terms and conditions.

Fair market value. Fair value is the price the leased property could be sold for between unrelated parties in an arm's length transaction.

Inception date. The date that a lease agreement or a written commitment is signed provided the property being leased is constructed or acquired by the lessor. (This is not the same date as the beginning of the lease term.)

Estimated residual value. Estimated residual value is the estimated fair value of the leased property at the end of the lease term. The estimated residual value shall not exceed the amount estimated at the inception of the lease.

Incremental borrowing rate. The rate that, at the inception of the lease, the lessee would have incurred to borrow, over a similar term, the funds necessary to purchase the leased asset.

Fiscal funding clause. A clause in a lease agreement providing that the lease is cancelable if the legislature or other funding authority does not appropriate the funds necessary for the government unit to fulfill its obligations under the lease agreement.

Implicit interest rate. The interest rate implicit in the lease is the discount rate that when applied to certain items results in an aggregate present value equal to the fair value of the leased property at the beginning of the lease term, less any investment credit expected to be realized and retained by the lessor.

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Lessee minimum lease payments. Normal minimum lease payments include:

1. The minimum rent called for during the lease term.
2. Any payment(s) or guarantee(s) that the lessee must make or is required to make concerning the leased property at the end of the lease term (residual value) including:
 - a. Any amount stated to purchase the leased property.
 - b. Any amount stated to make up any deficiency from a specified minimum.
 - c. Any amount payable for failure to renew or extend the lease at the expiration of the lease term.
3. The following should be excluded in determining the minimum lease payments:
 - a. A guarantee by the lessee to pay the lessor's debt on the leased property.
 - b. The lessee's obligation (separate from the rental payments) to pay executory costs (insurance, taxes, etc.) in connection with the leased property.
 - c. Contingent rentals.

Lessor's minimum lease payments. The minimum lease payments to a lessor are the sum of:

1. The minimum lease payments under the lease terms.
2. Any guarantee by a third party, unrelated to the lessee and lessor, of the residual value or rental payments beyond the lease term, providing such guarantor is financially capable of discharging the potential obligation.

Lease term. The lease term shall include all of the following time periods:

1. Any fixed noncancellable term.
2. Any period(s) covered by a bargain purchase option.
3. Any period(s) in which penalties are imposed in an amount that at the inception of the lease reasonably assures the renewal of the lease by the lessee.
4. Any period(s) covered by ordinary renewal options during which a guarantee by the lessee of the lessor's debt that is directly or indirectly

ATTACHMENT 4 (Page 3 of 3)

related to the leased property is expected to be in effect or a loan from the lessee to the lessor that is directly or indirectly related to the leased property is expected to be outstanding.

5. Any period(s) covered by ordinary renewal options preceding the date on which a bargain purchase option is exercisable.
6. Any period(s) representing renewals or extensions of the lease at the lessor's option.